IT 06-0002-PLR 03/09/2006 AMNESTY

Private Letter Ruling: Taxpayer whose liability for an amnesty year resulted from a disposition after the amnesty period of stock received in a reorganization in the amnesty year did not qualify for amnesty because the liability was created by the disposition. Accordingly, any interest and penalties attributable to the liability are not doubled.

March 9, 2006

Dear:

This is in response to your letter dated August 15, 2005, in which you request a Private Letter Ruling on behalf of COMPANY1. Review of your request for a Private Letter Ruling disclosed that all information described in paragraphs 1 through 8 of subsection (b) of 86 Ill. Adm. Code Section 1200.110 appears to be contained in your request. The Private Letter Ruling will bind the Department only with respect to COMPANY1 for the issues presented in this ruling. Issuance of this ruling is conditioned upon the understanding that COMPANY1 and/or any related taxpayer(s) is not currently under audit or involved in litigation concerning the issues that are the subject of this ruling request.

The facts and analysis as you have presented them are as follows:

Pursuant to Title 2 of the Administrative Code, Section 1200.110, COMPANY1 ("COMPANY1"), the Taxpayer, hereby requests a Private Letter Ruling ("PLR") with respect to the application of the Illinois Income Tax Act ("the IITA")[1], the Tax Delinquency Amnesty Act ("the TDA law")[2], and the Uniform Penalty and Interest Act ("the UPIA")[3]. Enclosed herewith is Form IL 2848 signed by the Taxpayer authorizing the undersigned to assist the Taxpayer in this matter.

A. Tax Period Involved

The requested PLR relates to a specific set of facts concerning the 1997 Illinois Income Tax Year and an amended Illinois return the Taxpayer will file, as a consequence of filing an amended federal income tax return for that year, to increase the Taxpayer's 1997 Illinois income tax liability.

COMPANY1 is not presently and has not previously been under audit by the Illinois Department of Revenue ("the Department") with respect to the 1997 Illinois income tax year and, more specifically, not with respect to the 2004 transaction described herein which requires the filing of 1997 federal and Illinois amended returns. The issue presented herein also does not arise with respect to any other COMPANY1 tax year that the Department may audit.

To the best of the Taxpayer's knowledge, information and belief, and that of the undersigned as well, the Department has not previously ruled on the same or similar issue for the Taxpayer or a predecessor, and neither the Taxpayer or the undersigned have previously submitted the same or similar issue to the Department and withdrawn the request before a ruling issued.

B. Statement of Authorities

Supporting Taxpayer's Position:

35 ILCS 5/101 et seq.

35 ILCS 735/3-1 et seq.

35 ILCS 745/1 et seq.

86 Ill. Admin. Code § 521.105.

86 Ill. Admin. Code § 700.400.

Moyer v. Bd. Of Ed. Of School Dist. No. 186, 391 Ill. 156, 62 N.E.2d 802 (1945).

In the Matter of the Collector's Application v. Crossfield Chemicals, 233 Ill. App. 3d 896, 586 N.E. 2d 1101 (1992).

Contrary To Taxpayer's Position:

Taxpayer is not aware of any authority involving similar facts under the TDA law, or of any precedent thus far interpreting the TDA law.

C. Facts

1997

During the 1997 Illinois income tax year, the taxpayer, COMPANY1 ("COMPANY1"), was a holding company domiciled in Illinois. COMPANY1 had a wholly-owned subsidiary named COMPANY2 ("COMPANY2").
During the tax year, COMPANY1 participated in a foreign joint venture ("the FJV"). In exchange for a 45 % ownership interest in the FJV, COMPANY1 executed a spin-off of COMPANY2 into the FJV pursuant to Internal Revenue Code ("IRC") Section 355.
As then required by Treasury Regulation 1.367(3)-IT [4], COMPANY1 entered into a gain recognition agreement ("the Agreement") under which no gain would be recognized in connection with the spin-off of COMPANY2 so long as COMPANY1's 55% ownership was not sold or otherwise disposed of for a period of ten years pursuant to Treasury Regulation Section 1.367(e)-1T(c)3(vii).[5]

2003

The TDA law became effective on the 20th of June, 2003. The TDA law allowed "taxpayers owing any tax imposed by . . . law of the State of Illinois and collected by the Department" to participate in an amnesty program between October 1st and November 15th of 2003.[6] Taxpayers participating in the amnesty program would escape interest and penalties for the tax liabilities reported through their participation, so long as the liabilities related to a tax period ending after June 30, 1983 and prior to July 1, 2002.

The TDA law provided that a taxpayer that "has a liability that is *eligible for amnesty* . . . and that fails to satisfy the tax liability during the amnesty period" would be charged interest on the liability and be subject to a penalty that would both be "imposed at a rate that is 200% of the rate that would otherwise be imposed," under the applicable law.[7]

The TDA law allowed the Department to implement a "voluntary" program.[8] The participation in the amnesty program was allowed to "eligible taxpayers" for "eligible liabilities" within the meaning of such terms in the UPIA as amended by the TDA law and the Department's regulations. The Department provided that "[a]ny liability that is not eligible for the Amnesty Program will not be subject to the 200% sanction imposed under 35 ILCS 735/3-2, 3-3, 3-4, 3-5. 3-6, and 3-7.5."[9]

If a liability was eligible for Amnesty the Department also provided that "a taxpayer must pay the entire liability for a tax type and tax period, irrespective of whether that liability is known to the Department or to the taxpayer, or whether the Department has assessed it."[10] Also, for a taxpayer that was under federal audit the Department provided that the "taxpayer may file an amended return reporting a federal change prior to receiving final notification from the Internal Revenue Service that the change has occurred."[11]

COMPANY1 was under federal audit prior to November of 2003, however, the 1997 period was closed August 25, 2002 (date the signing of the 4549). The gain recognition was not an issue during the audit as there was no ownership change as of that date. As of the 31st of December, 2003, there had been no change in ownership of the FJV sufficient to trigger the gain recognition agreement.

2004

In 2004, 100% of the stock of COMPANY1 was indirectly acquired by another company. The acquisition caused a change in ownership of the FJV and triggered the gain-recognition provisions of the Agreement. As a result, COMPANY1 recognized a gain in connection with IRC Section 355 spin-off of COMPANY2 in the 1997 income tax year.

2005

COMPANY1 is now required to file an amended federal income tax return for the 1997 tax year to report the gain of approximately $32 million

recognized as a result of the change in ownership of the FJV and the Agreement. Illinois law requires that COMPANY1 also report to Illinois through an amended return for the 1997 tax year the increase in Illinois income tax of approximately $1.2 million that will result from reporting the gain for federal income tax purposes. [12]

D. Rulings Requested

COMPANY1 requests the following ruling from the Department:

?? During October 1st through and inclusive of November 17th of 2003, COMPANY1 did not have a tax liability that was eligible for amnesty with respect to its 1997 Illinois income tax year.

?? COMPANY1's timely filing pursuant to Section 506(b) of the IITA with respect to the 1997 Illinois income tax year to report the Illinois tax effect of reporting for federal income tax purposes the gain recognized upon the change in ownership of the FJV, and the timely payment of any additional tax shown due on the Illinois amended return filed pursuant to Section 506(b), will not give rise to any penalty or interest that is subject the 200% multiplier the TDA law requires be applied to tax liabilities that were eligible for amnesty and were not reported and paid during the TDA law amnesty period.

In the alternative, COMPANY1 requests the following ruling from the Department:

* There is reasonable cause to abate any applicable penalties for the failure to report during the amnesty period a tax liability as yet unrecognized and unreported for federal income tax purposes.

E. Discussion:

COMPANY1's review of the TDA law, the IITA, the UPIA and the Department's regulations suggests that between the 1st of October and the 17th of November of 2003, there was no 1997 Illinois income "tax liability eligible for amnesty" under the TDA Law. No change of ownership had occurred in the FJV prior to the 17th of November of 2003. No gain had been recognized or been required to be recognized by COMPANY1 prior to the 17th of November of 2003 on account of the 1997 spin-off of COMPANY2. No federal audit examination was under way for the 1997 federal income tax year to put on notice COMPANY1 that it might have additional liability for some fact occurring in 1997 or since 1997 but prior to the 17th of November of 2003.

The liability for the 1997 federal and Illinois income tax years did not arise as a result of any fact in existence or event occurring during the 1997 tax year, nor from any fact in existence or occurring on or

before the 17th of November of 2003. While the liability relates to the 1997 income tax year, and must be reported for that year, the event triggering the recognition of gain occurred in 2004. It was factually not possible for the liability triggered by the occurrence of an event in 2004 to be an "eligible liability" between October 1st and November 17th of 2003. (emphasis added to original).

The IITA requires that a taxpayer "take into account the items of income, deduction or exclusion . . . in the same manner and amounts as reflected in such person's federal income tax return for the same taxable year." [13] As of the 17th of November of 2003, COMPANY1 had not been required to take into account in its federal return for 1997, or in an amended return for that year, the gain that would be recognized if within the 10 year period of the Agreement there was a change in ownership of the FJV. Consequently, it would have been inconsistent with the design and purpose of the IITA to conclude that COMPANY1 had a "tax liability . . . eligible for amnesty" and that COMPANY1 had to prepare an amended 1997 Illinois return for filing during the October 1st through November 17th amnesty period reporting a gain as yet unrecognized and unreported for federal purposes (the recognition of which being contingent on an event that might not occur within the 10 year period of the Agreement).

Generally under the IITA, the amount of tax shown due on an income tax return is "deemed assessed on the date of filing of the return (including any amended returns showing an increase in tax.)." [14] However, certain amended returns are assessed differently. Under the IITA, a change in Illinois income tax liability that is caused by the amendment of a federal tax return is required to be filed "not later than 120 days after" the federal amended tax return "has been agreed to or finally determined for federal income tax purposes or any federal income tax deficiency . . . resulting therefrom has been assessed or paid, whichever shall occur first."[15] When such a return is filed, "any deficiency resulting therefrom shall be deemed to be assessed on the date of filing of such report or amended return and such assessment shall be timely notwithstanding any other provisions" of the IITA.[16] Thus, in the case of COMPANY1, the additional 1997 tax liability arising from the change in ownership of the FJV and the recognition provision of the Agreement could not be deemed to be assessed in 1997, but rather will be deemed assessed in the year in which the amended return is filed.[17] Consequently, looking back to November 17th of 2003, even after the filing of the amended return reporting the federal gain recognition triggered in 2004 there will not have been a tax liability deemed assessed before July 1, 2002.

It was both factually and legally impossible for COMPANY1 to have "a tax liability . . . eligible for amnesty" during the amnesty period of October 1st through November 17th of 2003.

Were one to contend that COMPANY1 had an eligible tax liability and

therefore that it could have taken advantage of the amnesty program, one would have to state that COMPANY1 should be penalized with double penalties and double interest because: (a) during October 1st through November 17th of 2003 COMPANY1 did not anticipate that it might be acquired at some later date within the 10 year period of the Agreement; and (b) because it failed to make a prophylactic amnesty payment of the estimated amount of tax upon the gain that could be recognized. If COMPANY1 was not acquired within one year from the date of its prophylactic amnesty payment, COMPANY1 would lose the right to a refund of that payment unless it took a further contorted precaution.[18] Before the expiration of the 10 year period, but within one year refund statute of limitations period running from the date of its prophylactic amnesty payment, COMPANY1 would have had to file a claim for refund of its amnesty payment and then taken any procedural steps available to keep the claim pending until the expiration of the 10 year period in order to conclude, correctly, that no gain was recognized and that the amnesty payment was in error and should be refunded. [19]

It is a well established rule of statutory construction that if adherence to the literal language of a statute will lead to an absurd result, then that reasonable construction of the statute which does not render it ineffective should be preferred. Moyer v. Bd. Of Education of School Dist. No. 186, 391 Ill. 156, 62 N.E.2d 802 (1945). A statute should be construed in light of the general purposes and objects of the acts in order to effectuate the main intent and plan of that statute. Id, at 162, at 805. In The Matter of the Collector's Application v. Crossfield Chemicals, Inc., 223 Ill. App. 3d 896, 586 N.E.2d 1101 (1992). Interpreting the TDA law, the IITA and the UPIA to conclude that COMPANY1 should bear double penalties and double interest when it follows Illinois law and reports the federal amendment because it is viewed to have had a 1997 Illinois income tax liability that was eligible for amnesty in the period between October 1st and November 17th of 2003, would be the type of absurd result that the legislature could not have intended. (emphasis added to original).

In the alternative, for all the above stated reasons, Taxpayer submits that it exercised ordinary business care and prudence in determining its obligations under the IITA and the TDA law and hence made a good faith effort to determine and file and pay the proper tax liability, and thus there is reasonable cause for abatement of the penalties that are subject to the 200% multiplier the TDA law requires be applied to tax liabilities eligible for amnesty that were not reported and paid during the amnesty period.[20] The UPIA penalties do not apply if the failure to file a return or pay tax at the required time was due to reasonable cause.[21] Relying upon the foregoing exposition of the legal and factual surrounding circumstances leading to the filing of the 1997 Illinois amended return to report the effect of a federal amendment to the 1997 return, Taxpayer cites without further argument the following portions of the Department's reasonable cause

regulation that support a finding of reasonable cause in this instance:[22]

?? Inability to obtain records necessary to determine the amount of tax due to reasons beyond the taxpayer's control (the necessity of records was occasioned by events occurring after the amnesty period expired);

?? The taxpayer made an honest mistake (in assuming that it did not have to anticipate it might be purchased at some point after the amnesty period expired and before the expiration of 10 years and thus trigger liability eligible for the already expired amnesty);

?? The taxpayer's federal filing status caused confusion about the Illinois filing requirements (taxpayer was not required to report the as yet unrecognized gain for federal tax purposes and thus taxpayer would have been confused at having to report the same for Illinois purposes during the amnesty period);

?? The event giving rise to penalties could not reasonably have been anticipated (while it was possible that COMPANY1 would be acquired within the 10 year period, COMPANY1 could not anticipate that it would have to report the gain triggered by the acquisition before the acquisition occurred);

?? Reasonable care and prudence was exercised.

If after review of this ruling request the Department is inclined to deny or not to issue the requested rulings, or is inclined to issue only the ruling requested in the alternative, the undersigned requests the opportunity to meet or otherwise confer with the Department before it makes a final decision to explore avenues that may allow the Department to issue the requested rulings.

Lastly, in any correspondence issued by the Department which the Department intends or is required to make public the Taxpayer requests that the formal names of any entities referenced herein be omitted.

Department Response:

Section 3-2(f) of the Uniform Penalty and Interest Act (35 ILCS 735/3-2) provides:

If a taxpayer has a tax liability that is eligible for amnesty under the Tax Delinquency Amnesty Act and the taxpayer fails to satisfy the tax liability during the amnesty period provided for in that Act, then the interest charged by the Department under this Section shall be imposed at a rate that is 200% of the rate that would otherwise be imposed under this Section.

Section 3-3(i) of the Uniform Penalty and Interest Act (35 ILCS 735/3-3) contains a similar provision, doubling the penalty for late payment of taxes in the case of a liability that was eligible for amnesty but which was not satisfied during the amnesty period. Other penalty provisions of the Uniform Penalty and Interest Act also provide for doubling of the penalties otherwise applicable in the case of a liability that was eligible for amnesty and not satisfied during the amnesty period.

The Department's emergency regulation promulgated under the Tax Delinquency Amnesty Act at 86 Ill. Adm. Code Section 521.105(l) provided:

> A taxpayer who is under federal audit may participate in the Amnesty Program by following the procedure set out in subsection (k) above and making a good faith estimate of the increased liability that may be owed to the Department. For purposes of participating in the Amnesty Program only, a taxpayer may file an amended return reporting a federal change prior to receiving final notification from the Internal Revenue Service that the change has occurred. Although participants in the Amnesty Program may not seek or claim refunds, a limited exception to this rule will be permitted for taxpayers whose refund claims are based upon final determinations of the Internal Revenue Service or the federal courts.

Accordingly, a liability that otherwise met the criteria for participation in the amnesty program qualified for amnesty, even if the liability resulted from a final determination of the Internal Revenue Service or the federal courts made after the close of the amnesty program. A taxpayer who failed to report and pay the liability during the amnesty period would be subject to doubling of the interest and penalties otherwise due with respect to the liability under the Uniform Penalty and Interest Act.

In this case, however, the increase in the 1997 liability of COMPANY1 was not determined by applying the law to facts in existence as of the close of the 1997 tax year. To the contrary, the liability was created when the 2004 acquisition of the stock of COMPANY1 triggered the gain-recognition provisions of the Agreement. In this unique situation, therefore, there was no liability as of the end of the amnesty period that COMPANY1 could have reported and paid in order to participate in the amnesty program, because the transaction that actually created the liability had not yet occurred. Accordingly, the liability that resulted from the acquisition of COMPANY1 was not eligible for amnesty, and any interest and penalties otherwise due with respect to that liability will not be doubled under the Uniform Penalty and Interest Act.

The factual representations upon which this ruling is based are subject to review by the Department during the course of any audit, investigation, or hearing and this ruling shall bind the Department only if the factual representations recited in this ruling are correct and complete. This Private Letter Ruling is revoked and will cease to bind the Department 10 years after the date of this letter under the provisions of 2 Ill. Adm. Code 1200.110(e) or earlier if there is a pertinent change in statutory law, case law, rules or in the factual representations recited in this ruling.

Sincerely yours,

Jackson E. Donley,
Senior Counsel-Income Tax

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[1] 35 ILCS 5/101 et seq.
[2] 35 ILCS 745/1 et seq., (P.A. 93-26 -- S.B. 696), italics added.
[3] 35 ILCS 735/3-1 et seq.
[4] The cited regulation was no longer in effect after August of 1999, but it nevertheless continues to control the 1997 tax period.
[5] The cited regulation was no longer in effect after August of 1999, but it nevertheless continues to control the 1997 tax period.
[6] The Department's regulations implementing the TDA law extended the time to November 17th, as the 15th fell on a weekend and State law automatically extends the date to the next working date. 86 Ill. Admin. Code § 521.105(b).
[7] 35 ILCS 735/3-2(f); 35 ILCS 735/3-3(i); 35 ILCS 735/3-4(d); 35 ILCS 735/3-5(d); 35 ILCS 735/3-6(c); 35 ILCS 735/3-7.5(b); (P.A. 93-26, § 905).
[8] 86 Ill. Admin. Code § 521.105(b).
[9] 86 Ill. Admin. Code § 521.105(h)
[10] 86 Ill. Admin. Code.§ 521.105(j)
[11] 86 Ill. Admin. Code § 521.105(l).
[12] 35 ILCS 5/506(b).
[13] 35 ILCS 5/403(a).
[14] 35 ILCS 5/903(a)(1).
[15] 35 ILCS 5/506(b).
[16] 35 ILCS 5/903(a)(3). Note also that under Section 1101 of the IITA, there would be no lien in favor of the Department until the time the assessment is made, which in the case of a federal change is upon the filing of the amended return reporting the change. 35 ILCS 5/1101(b).
[17] Note as well that the time for issuing a notice of deficiency on an underreported or underpaid federal change runs from the time the notification of change is given, limited to deficiencies from the recomputation reported and not including deficiencies from the original return. 35 ILCS 5/905(e)(2)
[18] Under IITA Section 911(a)(1) a claim for refund must be filed before the later of three years after the filing date of the return, or one year after the date of payment of the tax.
[19] The IITA does not explicitly, and the Department does not administratively, provide a protective claim procedure, so COMPANY1's claim could be denied at any time before the expiration of the 10 year period as premature, i.e., not claiming a refund of an overpayment.
[20] The TDA law regulations provide that the TDA law has no impact on the meaning of "reasonable cause" as the term is used in the UPIA. 86 Ill. Admin. Code § 521.105(n)
[21] 86 Ill. Admin. Code § 700.400(a).
[22] 86 Ill. Admin. Code § 700.400(e)(4) and (e)(7), and (f)(1), (4) and (5).